

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-08 NSC-05

TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00

COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 H-01 PA-01 PRS-01 /086 W

-----110949 301109Z /16

P R 300740Z AUG 77

FM AMEMBASSY COPENHAGEN

TO SECSTATE WASHDC PRIORITY 5034

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY DUBLIN

AMEMBASSY THE HAGUE

AMEMBASSY HELSINKI

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY OSLO

AMEMBASSY PARIS

AMEMBASSY REYKJAVIK

AMEMBASSY ROME

AMEMBASSY STOCKHOLM

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USEEC

USOECD

EO 11652: NA

TAGS: EFIN EC ECON PINT DA

SUBJ: DANISH KRONE DEVALUATION

REF: (A) COPENHAGEN 1962 (B) COPENHAGEN 4976

SUMMARY. FOLLOWING THE SWEDISH DECISION TO FLOAT THE SWEDISH

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KRONE AUGUST 28, THE DANES DECIDED, IN LINE WITH THE NORWEGIANS, TO ADJUST THE CENTRAL RATE OF DANISH KRONER DOWNWARD BY FIVE PERCENT IN RELATION TO THE OTHER SNAKE CURRENCIES. IN TODAY'S FOREIGN EXCHANGE MARKET THE DEVALUATION OF KRONER BECAME ONLY PARTLY EFFECTIVE AS KRONER MOVED UP IN THE SNAKE. IN RELATION TO DOLLARS, KRONER DROPPED LESS THAN TWO PERCENT. THE EXCHANGE RATE RE-ALIGNMENT COMPLICATES THE CURRENT ECONOMIC-POLITICAL

NEGOTIATIONS. THE GOVERNMENT'S FISCAL RESTRAINT AND EMPLOYMENT INCENTIVE PROGRAM MAY BE SUPPLEMENTED BY MORE RIGID WAGE CONTROLS THAN HAVE ALREADY BEEN IMPLEMENTED. END SUMMARY.

1. THE DANISH GOVERNMENT ANNOUNCED SUNDAY EVENING, AUGUST 28, ITS DECISION TO DEVALUE THE DANISH KRONE BY FIVE PERCENT IN RELATION TO THE OTHER NON-SCANDINAVIAN CURRENCIES WITHIN THE EUROPEAN MONETARY COOPERATION (THE SNAKE). THE DECISION FOLLOWED A MEETING IN FRANKFURT WITH THE SNAKE PARTNERS AND A SWEDISH DECISION TO LEAVE THE SNAKE AND LET THE SWEDISH KRONE FLOAT UNDER CONTROL. THE NORWEGIANS REPORTEDLY MADE THEIR DECISION JOINTLY WITH THE DANES.

2. AS WAS THE CASE AT THE PRIOR RE-ALIGNMENT MEETINGS IN OCT 1976 AND APR 1977 (REF A), THE DANES ONLY RELUCTANTLY ACCEPTED A LIMITED DEVALUATION OF THE DANISH KRONE IN VIEW OF THE PRIMARY IMPORTANCE OF THE SWEDISH MARKET FOR DANISH INDUSTRIAL EXPORTS. DESPITE THE CONTINUING LARGE DANISH TRADE AND PAYMENTS DEFICITS, THE DANES THUS FAR HAVE BEEN SUCCESSFUL IN MAINTAINING FOREIGN

EXCHANGE RESERVES AT A COMFORTABLY HIGH LEVEL THUS PREVENTING ANY SEVERE PRESSURES AGAINST THE DANISH KRONE. DEVALUATION SO FAR HAS BEEN OPPOSED BY THE GOVERNMENT, THE CENTRAL BANK AND BUSINESS, AND THE SWEDISH DECISION CLEARLY WAS NOT POPULAR.

3. DESPITE THE RE-ALIGNMENTS IN OCT 1976 AND APR 77, WHERE IN LIMITED OFFICIAL USE

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BOTH INSTANCES THE DANISH KRONE WAS DEVALUED IN RELATION TO THE OTHER CURRENCIES IN THE SNAKE, THE INTERNATIONAL VALUE OF THE KRONE, ON A TRADE-WEIGHTED BASIS, HAS NOT BEEN REDUCED OVER THE LAST TWELVE MONTHS. IF THE EXCHANGE RATE IMPACT ON THE ECONOMY IS MEASURED IN TERMS OF THE AVERAGE RATE OF THE DANISH KRONE DURING THE LAST TWELVE-MONTH PERIOD AS COMPARED TO THE PRECEDING TWELVE-MONTH PERIOD (1975-76), THE KRONE WAS ACTUALLY REVALUED BY ABOUT 3.5 PERCENT.

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4. THE OCTOBER 1976 RE-ALIGNMENT HAD LITTLE REAL IMPACT ON THE MARKET RATE OF THE KRONE BECAUSE THE KRONE THEN HAD ROOM TO MOVE WITHIN THE SNAKE. CONVERSELY, AT THE APRIL 1977 RE-ALIGNMENT, THE KRONE WAS IN A MARGINAL POSITION ABOVE THE DEUTSCHMARK BUT THE EFFECT OF THE LARGER SWEDISH DEVALUATION STILL REDUCED THE OVERALL IMPACT ON THE DANISH KRONE FROM THE OFFICIAL THREE PERCENT TO ABOUT TWO PERCENT.
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5. AT THE NOON FIXING TODAY IN COPENHAGEN, DANISH KRONER DROPPED LESS THAN TWO PERCENT IN RELATION TO DOLLARS AND THE LEADING SNAKE CURRENCIES WHICH MEANT THAT, ACCORDING TO THE REVISED CENTRAL RATES, POSITIONS WERE REVERSED IN THE SNAKE, THE DANISH KRONE MOVING TO THE TOP AND THE DEUTSCHMARK TO THE BOTTOM. THIS IMMEDIATE MARKET REACTION WOULD SEEM TO CONFIRM EARLIER OFFICIAL DANISH ASSERTIONS THAT THE KRONE WAS NOT IN A POSITION THAT WOULD HAVE CALLED FOR DEVALUATION. SWEDISH KRONER, ON THE OTHER HAND, TOOK THE FULL TEN PERCENT DIVE IN TODAY'S MARKET, WHICH MEANS THAT THE DANISH EFFORT TO PROTECT ITS INTERESTS IN THE SWEDISH MARKET THUS FAR HAS NOT BEEN VERY EFFECTIVE.

6. THE SWEDISH DECISION CLEARLY WAS NOT VERY CONVENIENT FOR THE GOVERNMENT AS IT INTERFERES WITH THE CURRENT, DIFFICULT ECONOMIC-POLITICAL NEGOTIATIONS (REF B). FOLLOWING SEVERAL FAILURES TO ATTAIN IN ADVANCE MAJORITY SUPPORT FOR ITS COMPLEX OF FISCAL RESTRAINT AND EMPLOYMENT INCENTIVE BILLS, THE GOVERNMENT HAD DECIDED TO SUBMIT THE BILLS TO THE FLOOR TODAY FOR SECOND READING. BUT NOW, IN VIEW OF THE ADDITIONAL ECONOMIC FEATURES PRESENTED BY THE DEVALUATION, THIS READING WILL BE POSTPONED PENDING FURTHER NEGOTIATIONS DURING THE WEEK.

7. CONSIDERING THAT THE DEVALUATION AND ITS RESULTANT PRICE INCREASES WILL CAUSE SOME RESTRICTIONS ON CONSUMER SPENDING, THE PRESS SPECULATE THIS MORNING THAT THE GOVERNMENT'S FISCAL RESTRAINT (TAX INCREASE) BILLS MIGHT BE MODIFIED. HOWEVER, A SOURCE IN FINANCE MINISTER HEINESEN'S OFFICE TELLS US THAT THE GOVERNMENT HAS NO INTENTION OF MODIFYING THIS PART OF ITS PROGRAM IN VIEW OF THE EXPECTED, INITIALLY NEGATIVE EFFECTS OF THE DEVALUATION ON THE BALANCE OF PAYMENTS. THE INFLATIONARY EFFECTS OF THE DEVALUATION WILL BE SOMEWHAT CONTROLLED BY THE ALREADY IMPLEMENTED (SINCE LAST AUGUST) SUSPENSION OF PART OF THE WAGE LIMITED OFFICIAL USE

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ESCALATION SYSTEM. THE FINMIN SPOKESMAN INDICATED, HOWEVER, THAT THE GOVERNMENT MIGHT CONSIDER FURTHER FOLLOW-UP LEGISLATION TO CONTROL WAGE DRIFT. SUCH A PROPOSAL WOULD MEET A MAJOR OPPOSITION DEMAND, BUT WOULD CERTAINLY NOT MAKE THE NEGOTIATIONS EASY.
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